

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matters of:

Ameritech Corporation Telephone Operating)
Companies' Continuing Property Records)
Audit)

Bell Atlantic (North) Telephone Companies')
Continuing Property Records Audit)

Bell Atlantic (South) Telephone Companies')
Continuing Property Records Audit)

CC Docket No. 99-117

BellSouth Telecommunications' Continuing)
Property Records Audit)

ASD File No. 99-22

Pacific Bell and Nevada Bell Telephone)
Companies' Continuing Property Records)
Audit)

Southwestern Bell Telephone Company's)
Continuing Property Records Audit)

US West Telephone Companies' Continuing)
Property Records Audit)

NOTICE OF INQUIRY

Adopted: April 6, 1999

Released: April 7, 1999

By the Commission:

I. INTRODUCTION

1. By this Notice of Inquiry, we initiate a proceeding concerning certain accounting practices of the captioned companies (the companies). This inquiry is based on audits of the companies' hard-wired central office equipment conducted by the Common Carrier Bureau (Bureau). According to the Bureau's audit reports, upon a physical examination of the companies' central offices, neither company personnel nor Bureau auditors were able to locate certain central office equipment which is recorded in the companies' books and accounts. The Commission stated that it was not passing judgment on the accuracy of the reports, their findings or conclusions. We seek comment concerning issues arising out of these audit reports.

II. BACKGROUND

2. In Part 32 of its rules, the Commission prescribes a Uniform System of Accounts ("USOA") for telecommunications carriers. The USOA includes specific details about the property records that carriers must maintain. Specifically, Part 32 requires companies to maintain continuing property records (CPRs) and supplemental records that include: (1) a description of the property; (2) the specific location of the property; (3) the identification of the work order under which the unit was installed; (4) the year of installation of the property; and (5) any other information necessary to determine the original cost of the property. The rules require that the property be described in sufficient detail that it may be spot checked for physical verification of its existence.¹

3. The Common Carrier Bureau's auditors performed audits of the captioned companies to determine if their records were being maintained in compliance with the Commission's rules and to verify that property recorded in the accounts represented equipment used and useful for the provision of telecommunications services. Parts of the audits were conducted using statistical sampling techniques so that the findings for the sample could be extended as representative of all of the equipment in the category audited, *i.e.*, hard-wired central office equipment. The auditors' reports state that certain carrier records contained deficiencies and did not comply with the Commission's rules. The reports further state that certain equipment described in these records could not be found by the Bureau auditors or by company personnel during the field audits. Moreover, in their reports, the Bureau auditors state that companies' CPRs included records/accounting entries that had no description of the equipment or its location and were described as "undetailed investment" or "unallocated other costs."

4. The Bureau provided each of the companies with its respective audit report for comment. In their comments, the companies disagree with the auditors' conclusions. The companies describe deficiencies that they perceive in the audit procedures, raise questions about the validity of the auditors' findings, and complain that the Commission's rules are archaic, extraordinarily detailed and burdensome. The audit reports and the companies' comments were publicly released by the Commission on March 12, 1999.

III. ISSUES FOR INVESTIGATION

5. The Commission's accounting rules define the costs to be included in the regulatory books and accounting records of the companies. Once defined, these costs become the basis for a variety of regulatory applications including jurisdictional separations, allocation of costs between regulated and nonregulated activities, earnings calculations, access charge allocations and, ultimately, ratemaking. Accordingly, the financial information recorded on the regulated books serves as the basis for many of the Commission's decision-making activities.

6. The local exchange carrier business is capital intensive. Depreciation and other costs related to capital investment account for about half of the carriers' annual costs. These audits sought to determine whether the equipment, the costs of which are recorded on the companies' regulated

¹ See 47 C.F.R. §§ 32.2000 (e) and (f).

books, is properly described and physically exists. Compliance with the Commission's rules allows ready proof of physical existence, *i.e.*, whether the equipment is useful in the provision of telephone services, and whether the costs of such equipment are properly included in the companies' regulatory books and accounting records.

We, therefore, invite public comment on the following issues:

- Issue 1: The validity and reasonableness of the statistical sampling methodologies used by the auditors, including: sample design, the two-stage stratified sampling technique, balance and adjustments made to account for high-cost and lower-cost items, the audit procedures, extrapolation techniques, confidence intervals, and the application of Bayesian techniques;
- Issue 2: The validity and reasonableness of the methodology used by the Bureau's auditors in determining whether to rescore or to modify a finding during a field audit that equipment was "not found;"²
- Issue 3: To the extent the auditors' sampling, rescoring and other methodologies were valid, whether the degree of error in the CPR records determined by the auditors is sufficient to require corrective action;
- Issue 4: What accounting adjustments, if any, should be made to account for "missing" plant;³
- Issue 5: What accounting corrections, if any, should be used to resolve the undetailed investment⁴ identified in the audit reports;
- Issue 6: The recommendation of the auditors that the companies should be required to engage independent firms to perform an inventory of their entire central office equipment and provide the results to the Commission, and that the Commission should analyze the results of the inventory and direct the companies to make necessary entries to correct their CPRs and account balances;

² See *Public Notice*, "The Accounting Safeguards Division Releases Information Concerning Audit Procedures for Considering Requests by the Regional Bell Operating Companies to Reclassify or "Rescore" Field Audit Findings of Their Continuing Property Records" DA 99-668, (rel. Apr. 7, 1999), which is hereby incorporated by reference into the record of this proceeding. As with the audit reports themselves, the Commission does not pass judgment on the accuracy or merit of the procedures described in the ASD Public Notice.

³ The auditors categorized plant as "missing" when neither the Bureau auditors nor the company personnel accompanying the auditors could find the equipment during the field audits and if, subsequently, the companies were unable to submit documentation to permit the auditors to rescore or modify their prior findings.

⁴ "Undetailed investments" are listed on the CPR, showing dollar amounts and the dates they were placed on the CPR, but contain no other identifying information.

- Issue 7: The recommendation of the auditors that, in order to improve the likelihood that the CPRs will be maintained correctly in the future, the companies should be required to engage independent auditors to review their practices, procedures, and controls for maintaining CPRs and to make recommendations for improving these systems so that the CPR plant balances can be maintained in compliance with the Commission's rules (parties should address the specific recommendations concerning the practices, procedures, and controls addressed by the auditors in the recommendations sections of the audit reports);
- Issue 8: What ratepayer impact, if any, the alleged discrepancies in the CPR may have had, *e.g.*, through the derivation of the Commission's price cap rates, including re-initialization of price caps, sharing, lower formula adjustments, exogenous cost calculations, and changes to or setting of the productivity factors, joint cost allocations, separations, access charges, and ultimately ratemaking;
- Issue 9: Whether the property record discrepancies have any impact on (1) calculations under the Telecommunications Act of 1996 relating to (a) universal service support and (b) pricing of unbundled network elements, and (2) the merits of "takings" claims and "stranded costs" recovery; and,
- Issue 10: Any other issue or issues pertinent to the audit reports or the company responses. These issues may include but are not limited to: (1) the benefits of compliance with our rules, as well as the consistency of these rules with other statutory and regulatory policies; (2) the reasonableness of the auditors' interpretations of the CPR requirements; (3) the history and consistency of the FCC's procedure and enforcement of these requirements; and, (4) what other federal and state agencies do and what Generally Accepted Accounting Principles (GAAP) requires to ensure the accuracy of books and records.

IV. PROCEDURAL MATTERS

7. Pursuant to Sections 1.415, 1.419, and 1.430 of the Commission's rules, 47 C.F.R. §§ 1.415, 1.419, 1.430, interested parties may file comments on or before **June 7, 1999**, and reply comments on or before **July 7, 1999**. Comments may be filed using the Commission's Electronic Comment Filing System (ECFS) or by filing paper copies. *See* Electronic Filing of Documents in Rulemaking Proceedings, 63 Fed. Reg. 24,121 (1998). All filings should reference the CC Docket No. 99-117 and the applicable file number, ASD File No. 99-22.

8. Comments filed through the ECFS can be sent as an electronic file via the Internet to <<http://www.fcc.gov/e-file/ecfs.html>>. Generally, only one copy of an electronic submission must be filed. If multiple docket or rulemaking numbers appear in the caption of this proceeding, however, commenters must transmit one electronic copy of the comments to each docket or rulemaking number referenced in the caption. In completing the transmittal screen, commenters should include their full name, Postal Service mailing address, and the applicable docket or rulemaking number. Parties may also submit an electronic comment by Internet e-mail. To get filing instructions for e-mail comments, commenters should send an e-mail to ecfs@fcc.gov, and should include the

following words in the body of the message, "get form <your e-mail address." A sample form and directions will be sent in reply.

9. Parties who choose to file by paper must file an original and four copies of each filing. If more than one docket or rulemaking number appear in the caption of this proceeding, commenters must submit two additional copies for each additional docket or rulemaking number. All filings must be sent to the Commission's Secretary, Magalie Roman Salas, Office of the Secretary, Federal Communications Commission, 445 12th Street, S.W., Counter TWA 325, Washington, D.C. 20554. Comments are *no longer accepted* at the Commission's facilities located at 1919 M Street, N.W., Washington, D.C. 20554.

10. Subject to the provisions of 47 C.F.R. § 1.1203 concerning "Sunshine Period" prohibitions, this proceeding is exempt from ex parte restraints and disclosure requirements, pursuant to 47 C.F.R. § 1.1204(b)(1). Because many of the matters on which we request comment in this NOI may call on parties to disclose proprietary information such as market research and business plans, we suggest that parties consult 47 C.F.R. § 0.459 about the submission of confidential information.

11. For additional information regarding this proceeding, contact Andrew Mulitz at amulitz@fcc.gov or (202) 418-0850.

V. ORDERING CLAUSE

12. Accordingly, IT IS ORDERED that, pursuant to section 403 of the Telecommunications Act, 47 U.S.C. § 403, this Notice of Inquiry IS ADOPTED.

FEDERAL COMMUNICATIONS COMMISSION



Magalie Roman Salas
Secretary